

Estate Tax Repeal - How Does It Affect Your Estate Plan?

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) has greatly altered the federal estate tax and may have a severe impact on many estate plans. Under EGTRRA, the estate tax and generation-skipping transfer (GST) tax were repealed as of January 1, 2010 (the gift tax was not repealed and currently has a \$1,000,000 exemption with a top rate of 35%). However, under the provisions of EGTRRA, this repeal is temporary because as of January 1, 2011, EGTRRA "sunsets" and these taxes are reinstated at their pre-2001 levels - a \$1,000,000 exemption and a top rate of 55% (also applicable to the gift tax).

It was commonly believed that Congress would not let this temporary repeal take place and would either pass a temporary extension of the 2009 levels (\$3,500,000 exemption/45% top rate) or pass permanent estate tax reform legislation. However, Congress failed to enact any type of legislation in 2009 and allowed the estate and GST taxes to temporarily expire.

It is important for taxpayers to review their existing estate planning documents with their estate planning advisor to ensure their wishes are being fulfilled. Many trust and will provisions use formula clauses to allocate property among the family members. Many of these formula clauses assume there will be a federal estate tax and rely on certain defined terms within the provisions of the estate tax to be operational. As a result of the repeal, these formula clauses may result in unintended consequences.

For example, a person with a \$10 million estate may have a formula provision that provides for the maximum amount that can pass free from estate tax (\$3,500,000 in 2009) to pass to the children, with the balance passing to the surviving spouse. The intention would be to maximize the estate tax savings, while providing the surviving spouse with the bulk of the property. However, due to the repeal of the estate tax, the entire \$10,000,000 would pass to the children (since 100% can pass free of estate tax), and the surviving spouse would receive nothing.

It is impossible to predict what Congress may do with respect to the estate and GST taxes, but there are generally three likely possibilities:

1. Do nothing - EGTRRA would then give us a one-year repeal of the estate tax and GST tax, and a reinstatement as of January 1, 2011, at pre-2001 levels.
2. Pass new legislation effective prospectively - Congress could pass legislation that would re-instate the estate tax and GST tax with a newly defined level of exemption and rates.
3. Pass retroactive legislation - This would attempt to keep the estate and GST taxes in place and uninterrupted, and basically repeal the "repeal."

Most experts expect that if Congress passes retroactive legislation, it will most certainly be challenged as unconstitutional. The success of such a challenge cannot be predicted, and it may take several years to be determined. However, taxpayers may wish to take advantage of the lower gift tax rate and lack of GST tax in the current environment, but do so with caution due to the possibility of retroactive legislation.

For more information, contact Joyce Waterbury at 919.301.6715.

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